No. 19985

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MORRIS STEINBERG,

Appellant,

vs.

J. L. DORFMAN, *et al.*,

Appellees.

APPELLANT'S REPLY BRIEF.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

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Appellees' Statement of the Case.

Appellees' reply brief does not offer a sustained argument substantiating their position but rather contains a hodge-podge of contentions which are not related to the conclusions which they desire. The purported facts set forth in Appellees' statement of the case are misleading and for the most part, erroneous. Appellees state: "He made money in his business; he did not lose" (Appellees' Br. p. 2). Reference is made to the Bankrupt's testimony at the continued first meeting of creditors. However, it has been demonstrated that the Bankrupt was not his own accountant and did not know the profit and loss figures or the particular information contained in the books and records [Rep. Tr. Vol. 3, pp. 20, 65, 66, 72, 73, 75]. Question by Mr. Elmore: "You did make money in your business?" Answer by Mr. Steinberg: "Whatever is on the record" [Rep. Tr. Vol. 3, p. 72]. Furthermore the certified public accountant testified that the business reflected a loss of $3,671.00

from March 31, 1961, to March 31, 1962; a loss of $8,700.00 from March 31, 1962, to March 31, 1963; and a loss of $4,000.00 from April 1, 1963, to September 30, 1963 [Rep. Tr. Vol. 4, p. 56]. There were no profits from which the Bankrupt could obtain moneys in addition to those he accounted for.

Appellees state: "Moneys loaned to him for the purpose of operating his scrap metal business, all incurred within a year or so prior to his bankruptcy [Ex. 2, p. 27]" (Appellees' Br. pp. 2-3). There is no language remotely connected with this assertion at the cited portion of the testimony at the continued first meeting of creditors. Furthermore the Bankrupt testified that moneys were loaned to him over a three year period and the purpose was sometimes personal, sometimes business and bookkeeping entries were made accordingly [Rep. Tr. Continued First Meeting, pp. 6-7].

Appellees state: "He testified that he lost about $160,000.00 in gambling. This was 'just a guess'; he had 'no way of really keeping it accurate' but it was 'his best judgment'" (Appellees' Br. p. 3). This may be an approximation of what the Bankrupt said at the continued first meeting of creditors but it is misleading because the Bankrupt further testified that his estimate of $160,000.00 losses covered the three year period prior to bankruptcy and furthermore the Bankrupt explained in detail each gambling transaction and the amount won or lost for the year period prior to bankruptcy at the hearing on objections to discharge. He testified that he had refreshed his recollection through reference to various records and conversations and that the amount lost by him in the year prior to bankruptcy was $93,000.00. This amount was established as all that was available.

Appellees claim: "He made no entries in his bank records of any of these counter or customer's checks which he used for gambling, and there were many of these in substantial amounts" (Appellees' Br. p. 4). There is no such testimony at the section cited [Rep. Tr. Vol. 3, pp. 38-40] even if there were such language, it would not be of import. The counter checks which were referred to were merely further evidence that gambling in fact took place as the payees were often indicative of the place of the expenditure of funds. The business books of account do not reflect transactions which do not pertain to the business, and so the personal counter checks were properly not entered on the business records. The moneys drawn from the business of the Bankrupt and charged to his drawing account on a personal basis are available to the Bankrupt to be utilized as desired and all that the bankruptcy law requires is that a satisfactory explanation be made of any losses incurred. This has been done.

Appellees assert: "He made no entries in his business books of these winnings" (Appellees' Br. p. 4). This contention, repeatedly argued by the Appellees, is indicative of the fact that the Appellees have never understood what accounting principles are properly applicable herein. The ultimate source of deposits made to the business bank account is not relevant in determining whether bookkeeping methods were adequate. The cash receipts journal merely reflects the person who issued the check deposited or the person who contributed the cash deposited. When money is received, a debit is made to the cash account and a credit is made to a loan payable or to sales or to the capital account if the person contributing was the Bankrupt. It does not

matter where the Bankrupt got the funds he contributed. A credit is made to his capital account regardless of the source. As a matter of fact, substantial contributions to capital were made by the Bankrupt but even if he had made none, this would not be a basis or a ground for objecting to discharge. He need not have deposited any gambling winnings. Nevertheless, the Bankrupt testified at great length that winnings were in part retained for further gambling and in part deposited into the business bank account [Rep. Tr. Vol. 4, pp. 3, 6, 26].

Appellees' refusal to accept the Bankrupt's statement that he sent his employee, Wade Watson, to the race track without getting a receipt for moneys entrusted (Appellees' Br. p. 5) denotes a tinge of class consciousness on behalf of Appellees and also indicates a lack of understanding of human relationships. The Bankrupt's testimony is not in the slightest discredited because of his trust and affection for Mr. Watson or the Bankrupt's obvious loose method of handling funds.

Appellees contend Bankrupt was not too precise about his race track activities, citing language such as "probably", "usually", "I figured" and "I am not positive" (Appellees' Br. p. 5). As stated in Appellant's Opening Brief herein, the Bankrupt could not reasonably be asked to state the amount of each and every betting transaction entered into or its disposition because the event took place too quickly for recordation. Nevertheless the Bankrupt testified at length as to dates, places, persons present and approximate amounts of winnings and losses as to each gambling transaction entered into. His testimony was corroborated. All funds available were shown to have been expended. No

more is required. Furthermore, as pointed out in Appellant's Opening Brief, the Appellees have failed to sustain their burden of proof as to each of the grounds asserted as a bar to discharge and therefore there need not even be a consideration of Bankrupt's explanation of losses.

Appellees' statement that the Bankrupt's accountant confirmed a loss of $160,000.00 (Appellees' Br. p. 6) is without merit. The accountant merely replied in the affirmative to a statement by counsel that losses had been claimed [Rep. Tr. Vol. 4, p. 69].

Appellees state: "The Bankrupt testified he used the word 'loan' to cover up for gambling" and "The accountant testified that the use of the word 'loan' was not keeping adequate records" (Appellees' Br. pp. 6-7). Again, the argument of Appellees misses the point. If moneys are withdrawn by the Bankrupt they are charged to his drawing account whether the notation "personal use for gambling" or the notation "personal use for payment of personal loan" is made. This is standard accounting procedure, is not deceptive, and does not change the income statement or the balance sheet of the business. In addition, if money is contributed to the business by the Bankrupt, his capital account is credited whether a notation is made "I got the money from gambling winnings" or "I got the money from a personal loan." As a practical matter, the type of notations indicated are not made because they have no relevance. The accountant testified he was not too concerned about the reason for withdrawals because if it did not reflect a business entry, he simply charged the Bankrupt's drawing account [Rep. Tr. Vol. 4, p. 64].

Appellees claim: "The accountant admitted that the Bankrupt's records showed 'only what you could determine from the records he gave you or from the information he told you verbally" (Appellees' Br. p. 7). It is axiomatic that business records must be prepared from information supplied by the businessman. This makes no argument for Appellees whatsoever. The accountant testified that these books were kept in the same manner as other businesses of this type according to standard accounting principles and they reflect the business transactions and financial condition of the Bankrupt [Rep. Tr. Vol. 4, pp. 51, 53]. Furthermore the accountant testified that the information from which the books and records were prepared was a reflection of the activities of the Bankrupt's bank accounts [Rep. Tr. Vol. 4, p. 52] and so a check and balance was put upon the data submitted by the Bankrupt.

Appellees state: "The accountant admitted that he could not relate the Bankrupt's records to standard accounting principles, and that practices used by the Bankrupt were not keeping adequate records" (Appellees' Br. p. 7). The cited references [Rep. Tr. Vol. 4, pp. 80-81] do not support the assertion of Appellees. At page 80 of Volume 4 of the Reporter's Transcript, counsel for Appellees asked the witness to relate the Bankrupt's methods rather than the accountant's methods to standard accounting principles. The two cannot be separated because they depend upon each other. The witness was not given a chance to complete or explain his answer. His previous testimony clearly indicated that standard accounting principles were followed: "The condition of the books and records is that they adequately reflect the transactions of the business entity" [Rep.

Tr. Vol. 4, p. 46]. As to the statement by the accountant at page 81 of Volume 4 of the Reporter's Transcript that showing the word "loan" for a gambling transaction is not keeping adequate records, the preceding colloquy must be considered in which the accountant's position that the books were adequate was clearly stated. The question before the witness was vague and confusing. The accountant further testified [Rep. Tr. Vol. 4, p. 86] that the Bankrupt did keep adequate records of all of his transactions.

Appellees' Statement of Findings of Fact and Conclusions of Law.

Bankrupt accepts Appellees' statement of the findings of fact. Bankrupt recognizes the general rule that such findings must be shown to be clearly erroneous. This general rule prevails whether a review is taken to the District Court from the referee's decision or not. The citation at page 13 of Appellees' brief does not bear out their contention that the burden is increased under these circumstances. It is contended by Bankrupt that Findings of Fact did not follow from the evidence presented and that such findings were clearly erroneous. Each of the findings and the conclusions following therefrom are challenged by Bankrupt on the basis set forth in Appellant's Opening Brief. Adequate records were kept and introduced by the Bankrupt and a complete and satisfactory explanation was made of the loss incurred. Appellees furthermore failed to sustain their burden of proof as to each of their asserted grounds for objection to discharge.

Appellees' Argument.

Appellees claim: "He endeavored to account for the losses of large sums of money by nothing more than his memory and his word-of-mouth evidence" (Appellees' Br. p. 13). This is an incorrect appraisal of the circumstances. The Bankrupt introduced checks specifically related to a particular gambling incident, check stubs, race track loss tickets in large denominations in sequence for the time period in question and a sheet, properly authenticated, with the names, dates and amounts bet, won and lost on particular horses. The statements of the Bankrupt were corroborated by the witnesses Carl Segal and Wade Watson. Had the Bankrupt not had documentation of his gambling transactions, his testimony alone would be sufficient. There has been no showing by Appellees that the testimony of the Bankrupt alone would not suffice. The question is not whether there is documentation but whether the Bankrupt sufficiently details his explanation so that it is plausible and complete. Here, the Bankrupt specifically enumerated each betting transaction in which he was involved in the year prior to bankruptcy, setting forth the time, the place, the persons present, the amount available, the type of betting transaction, the amount bet and the amount won or lost. This testimony was not contradicted and was sufficient.

Appellees' Statement Regarding Adequacy of Records.

Appellees cite *Matter of Underhill,* 82 F. 2d 258 (C.C.A. 2nd Cir.) at page 14 of their brief for the proposition: "Records of substantial completeness and accuracy are required so that they may be checked against the mere oral statement or explanations made by the

Bankrupt." The records referred to are business records and the Bankrupt in the instant matter has introduced such records and his certified public accountant has stated that the records were adequate to determine business transactions as well as financial condition. Oral explanations have been made by the Bankrupt regarding his personal expenditures, particularly gambling. This testimony has been corroborated. Furthermore, documentation concerning personal expenditures has been introduced. The requirement set forth in *Underhill* is amply satisfied. In this regard the statement in *Remington on Bankruptcy,* Sec. 3111, page 232, that records are not required for personal expenditures, is pertinent.

Appellees cite *In re Davis* (E.D.N.Y. 1962), 208 F. Supp. 508 at page 15 of their brief for the proposition that the Bankrupt cannot escape on the ground that gambling losses are a personal expense. However, this case, as is the situation in all other cases cited by Appellees, turns on the fact that the Bankrupt did not explain his gambling loss. The Court states: ". . . but maintained no records of dates or amounts of wagers, or of tracks at which, or horses upon which, he wagered, where he offered no corroborating testimony or details as to losses and no explanation for failure to keep books, records or evidence of losses except that they were gambling losses" (Appellees' Br. p. 15). The Bankrupt in the instant matter detailed his losses, had records supporting his allegations and offered corroborating testimony.

Appellees argue at page 16 of their brief that one who gambles should be required to keep records of each gambling session and then enter the same in his busi-

ness books, and also to deposit the winnings in her business bank account. No authority is cited and this is simply not the law; rather it is a statement of Appellees' preferences. The business books are records of business transactions and by definition do not include such matter. The question of deposit of winnings has been previously considered and shown to be an irrelevant argument based on Appellees' lack of understanding of accounting methods.

Appellees state: "His checks and check stubs were wholly insufficient and incomplete. They were not all presented. He could not explain their absence. A great many checks were so-called counter or customer's checks obtained from hotels or gambling establishments payable to cash, not reflected in his check stubs at all" (Appellees' Br. p. 16). Appellees do not tell us for what purpose the Bankrupt's checks and check stubs must be sufficient and complete. There is no requirement that checks and check stubs be kept. The only requirement involved in determining adequacy of records is whether books of account were kept and whether such books were sufficiently complete and correct. There is no contention here that the books themselves were not adequate. As previously stated, the fact that counter checks were made by the Bankrupt has no significance in determining adequacy of the books and records because personal expenditures are not properly included in the business records.

Appellees argue: "Stubs were incomplete, in many cases without even a notation of the amount or name or date. The Bankrupt even mislead his own accountant telling him many of these checks cashed and moneys were the subject of loans." (Appellees' Br. p. 16).

Again, it must be pointed out that we are concerned with the adequacy of the books and records, not with the adequacy of the check stubs. Information not present on check stubs or determinable from the payee of the check may properly be determined from the statements of the businessman. There was no misleading of the accountant by the Bankrupt in designation of the purpose of the particular checks made. When a non-business payee was designated, the checks were properly charged to the drawing account of the Bankrupt. This is standard accounting technique which apparently is lost on Appellees.

Appellees state: "In numerous cases he could not even identify the handwriting of the person who wrote the word 'loan.' He ran his business and personal accounts together." (Appellees' Br. p. 17). What the significance of the Bankrupt's being unable to identify the handwriting of the person who wrote the word "loan" is not made clear, if such was in fact the case. Appellees cite Reporters Transcript Vol. 4, page 27 for their statement that the Bankrupt ran his business and personal accounts together. There is no language at the cited reference which even remotely approximates the statement of the Appellees. The Bankrupt did not run his business and personal accounts together, but if he had, it would not be grounds for bar of discharge.

Appellees claim: "Even his accountant testified that there was no record of the deposit of any gambling winnings." (Appellees' Br. p. 17). Appellees cite Reporter's Transcript Vol. 4, page 33 for reference to the comment made. The section cited contains no language whatsoever connected with the statement made by Appellees. No such testimony was made by the accountant.

Appellees state: ". . . he claims that all he won was $10,000, $8,000 and $1,000 twice, an utterly preposterous contention. He does not appear to be a novice at this type of activity; he had considerable experience." (Appellees' Br. p. 18). Experienced gamblers have been known to indulge in innumerable sessions of gambling without producing a winning session. A claim of winnings as set forth by Appellees would certainly not be preposterous. However, such was not the contention of the Bankrupt. For example, the Bankrupt testified [Rep. Tr. Vol. 2, p. 22] that he won $2,500 dollars on his personal trips to Hollywood Park. Furthermore, the Bankrupt testified that the horses given to him as part of the Pete Moreno swindle oftentimes produced winnings but that the net result was a loss [Rep. Tr. Vol. 2, p. 34].

Appellees assert: "Here, the 'losses' do not square with the deficiency in assets, and the business transactions cannot be ascertained from the records." (Appellees' Br. p. 18). The losses sustained by the Bankrupt in his gambling transactions "square" exactly with the assets shown to have been available during the year prior to bankruptcy and to have been dissipated in that period. Appellees' statement that that the business transactions cannot be ascertained from the records is without merit and simply ignores the realities of the books of account submitted as evidence and the testimony of the certified public accountant who prepared them.

Appellees' Statement Regarding Explanation of Losses.

Appellees cite *Siegal v. Cartel,* 164 Fed. 691 (C.A. 9, 1908) for the proposition that a person who gambles will not be granted a discharge in bankruptcy (Appellees' Br. p. 20). It is necessary only to look to the language of the Court in the *Siegal* case to determine the basis for denying discharge in bankruptcy: "He did not introduce any evidence corroborative of the losses at gaming. He failed on close inquiry to give the name of one person with whom he played or the name of the proprietor of the establishment where he played . . . he could give no particular dates or particular sums lost at the 'sittings' " (Appellees' Br. pp. 20 and 21). The facts in that case are completely different from the facts in the instant matter. The Bankrupt here made a complete and full explanation which would easily have satisfied the various tests set forth in the *Siegal* case.

Appellees cite *Gaudet v. Cowen,* 297 F. 2d 227 (C.A. 5, 1961), cert. den. 370 U.S. 950, 8 L. Ed. 815, 82 S. Ct. 1598, as a case standing for the proposition that the Bankrupt should be denied discharge because of failure to keep books and records (Appellees' Br. p. 21). Again, the language of the Court must be looked to: "He had no cancelled checks, check stubs, bank statements, records of receipts or expenditures. He failed to make such disclosure as is a condition precedent to discharge." (Appellees' Br. pp. 21 and 22). The facts established in *Gaudet* are significantly different than the facts established in the instant matter.

Another case regarding denial of discharge because of gambling losses sustained cited by Appellees is *Crider v. Jordan,* 255 F. 2d 378 (C.A. 4, 1958) (Appellees'

Br. p. 22). A complete response to Appellees' inference is contained in the language of the Court in that case: ". . . he kept no records and retained no memory of the details of his losses . . . $10,000 of assets disappeared without any record whatsoever being made on the books or any explanation of its disposition . . . without any explanation except that it had disappeared in gambling transactions of which the Bankrupt had no records and no definite recollection" (Appellees' Br. pp. 22 and 23).

Appellees claim: "His deposits and withdrawals and general loss of assets do not coincide; there is a half-baked attempt to reconcile the figures obtained by the accountant, in part, on information in the schedules in bankruptcy, which attempt itself has failed. The accountant could not even explain why he needed to consider the Bankruptcy Schedules" (Appellees' Br. p. 23). How deposits and withdrawals and general loss of assets would coincide in any circumstances is unknown since they have no relevance to one another. The basis of the Appellees' comment that the record of cash flow prepared by the C.P.A. "has failed" is not explained. As pointed out in Appellant's Opening Brief herein, the bankruptcy schedules were properly utilized to determine the statement of cash flow since the bankruptcy schedules are the statement of the Bankrupt, under oath, of his liabilities at the time of bankruptcy. The schedules are based upon the records of the Bankrupt, the knowledge of the Bankrupt, the data of the various creditors as it is available to the Bankrupt. This checked against the proofs of claim in bankruptcy. Some is not hearsay, it is a statement of fact and can be of these liabilities were entirely personal so were not re-

corded on the books of account of the Bankrupt. But the moneys obtained were available during the period in question, so those amounts not reflected in the business records must necessarily be included in a statement showing all cash available and all cash distributed. The accountant explained quite adequately why he needed to consider the Bankruptcy Schedules [Rep. Tr. Vol. 4, p. 92].

Appellees state: "The Bankrupt produced in evidence Exhibit F, two sheets with a list of horses on which he bet and had substantial losses; they contained numerous hieroglyphics which are not intelligible to anyone looking at the documents and even he had difficulty in deciphering it. The items were not reflected in his permanent records." (Appellees' Br. p. 24). The list of horses involved in the Pete Moreno swindle was explained at length by the Bankrupt and testimony was given which indicated the name of each horse bet on, the amount bet on the horse and the disposition of the bet. This certainly makes the document decipherable and lays a complete and proper foundation for its introduction into evidence which was not objected to by Appellees. The fact that the items on the list of horses were not transferred to the permanent records is of no consequence since this data is not properly a part of the business books and records. Again, Appellees fail to demonstrate cognizance of basic accounting practices.

Appellees state: "There was no explanation why he had no gambling tickets covering losses at Bay Meadows or Del Mar, race tracks away from Los Angeles, where he also placed substantial bets and had large losses." (Appellees' Br. p. 25). It is not common to retain race track tickets reflecting bets on losing horses. There is

no requirement that this be done and it is not necessarily a part of an explanation of gambling losses. The fact that the Bankrupt had substantial sequence tickets from bets made at Hollywood Race Track is simply further corroborative evidence of the fact that the Bankrupt did gamble. Appellees' suggestion that there must have been losing race track tickets submitted by the Bankrupt in order for him to make a proper explanation of his gambling losses is indicative of the overall manner in which the Appellees have approached this matter. They have raised irrelevant and inconsequential factors and argued heatedly that their own dissatisfaction with the submissions of the Bankrupt as to these irrelevant and inconsequential matters is determinative of the disposition to be made in this matter.

Appellees' Conclusion.

Appellees argue: "This is without a doubt a most flagrant case of dissipation of assets to come before a bankruptcy court. The amount of the losses claimed to have been lost at gambling far exceeds the losses in any of the reported cases" (Appellees' Br. p. 27). This statement summarizes the misconception with which Appellees have approached this matter from its inception. Dissipation of assets is not a grounds of discharge. Gambling is not a grounds of discharge. No matter how substantial the loss of assets is, if a satisfactory explanation is made of such loss, discharge must be granted. Appellees are attempting to add a new statutory ground for the denial of discharge and their attempt should be viewed not emotionally, as has been done thus far, but realistically in the light of the existing bankruptcy statutes and requirements. The Bankrupt had adequate records. The Bankrupt satisfactorily explained his loss.

Furthermore, the Bankrupt need not have responded to the unsupported allegations of Appellees. Appellees came forth with no evidence of their own. No expert witness was produced by them concerning adequacy of books and records. No testimony was offered by them in any way contradicting or diminishing the detailed explanation of Bankrupt. Their entire cases rests upon the statements of Bankrupt made at the continued first meeting of creditors. These statements have not been shown to be a basis for establishing the claims of Appellees and in addition, the Bankrupt's testimony has been amplified and made more specific by his comments at the hearing on discharge. Appellees cannot accept what they feel suits their purpose of Bankrupt's testimony, reject the balance without evidence and claim they have made a case by sitting idly by. The referee's decision as well as the decision of the district judge on review should be reversed.

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RODNEY MOSS